No. 11,688

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THOMAS H. BRODHEAD, doing business as T. H. Brodhead Co.,
Appellant,

vs.

WILLIAM BORTHWICK, Tax Commissioner and Tax Collector of the Territory of Hawaii,
Appellee.

Upon Appeal from the Supreme Court for the Territory of Hawaii.

BRIEF FOR APPELLANT.

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BRIEF FOR APPELLANT.

STATEMENT AS TO JURISDICTION.

This case involves the tax liability of appellant under Act 141 (Series A-44), Session Laws of Hawaii 1935, as amended, hereinafter referred to as the "General Excise Tax Law", and arises from an action brought in the Circuit Court, First Judicial Circuit, Territory of Hawaii, pursuant to Section 571, Revised Laws of Hawaii 1935, to recover taxes paid under protest (R. 2). Judgment was entered on September 13, 1944, for the recovery by appellant of the money paid under protest. A writ of error issued out of the

Supreme Court of the Territory of Hawaii on September 16, 1944. By order of the court, this case (No. 2583), and a similar case (No. 2581), were consolidated for briefing and hearing.

In an opinion covering the consolidated cases filed on March 4, 1946, the Supreme Court, with one justice dissenting, reversed the judgment appealed from and remanded the case for a new trial (R. 191). The petition for a rehearing of the appellant, filed March 22, 1946 (R. 238), was denied on March 27, 1946 (R. 246), and an order reversing the judgment appealed from and remanding the cause for a new trial was filed on April 9, 1946. On May 15, 1946, judgment dismissing the action was filed in the Circuit Court, First Judicial Circuit, Territory of Hawaii (R. 107), and, on August 7, 1946, a writ of error issued out of the Supreme Court (R. 177). On February 25, 1947, the Supreme Court, with one justice dissenting, affirmed the judgment of the Circuit Court (R. 187), and entered judgment accordingly (R. 189). On May 22, 1947, this appeal was filed pursuant to Sec. 128 of the Judicial Code (28 U.S.C.A., Sec. 225) (R. 259).

This case involves the Constitution of the United States, particularly Article I, Section 8, Clauses 12 and 13, and the Fifth Amendment thereto. It also involves statutes of the United States, particularly the Organic Act of the Territory of Hawaii (April 30, 1900, 31 Statutes at Large 141, Chapter 339, as amended).

The value in controversy, exclusive of interest and costs, exceeds $5000.00.

STATEMENT OF THE CASE.

Appellant, Thomas H. Brodhead, a resident of Honolulu, City and County of Honolulu, Territory of Hawaii, during the period here in question, was the general partner of a registered special partnership doing business under the firm name and style of T. H. Brodhead Co. (R. 19-20).

Appellee is, and was at all relevant times, the duly appointed, qualified and acting Tax Commissioner of the Territory of Hawaii, and as such, is and was in charge of the administration of the General Excise Tax Law (R. 20).

Appellant, during the period here in question, carried on a regularly established wholesale business, known to the trade as such (R. 148-149). Appellant filed gross income tax returns, in all respects as required by the General Excise Tax Law, for the period in question (R. 20).

From the time of enactment of the General Excise Tax Law in 1935 until after December 31, 1941, no taxes under the General Excise Tax Law were attempted to be imposed by the Territory of Hawaii with respect to sales to the United States, its agencies or instrumentalities (R. 152-3, 155), except with respect to the proceeds of construction contracts as distinguished from sales and purchase contracts (R. 156). Sales to post exchanges were sought to be taxed at ¼ of 1% during this time under an Attorney General's opinion to the effect that post exchanges were not agencies or instrumentalities of the United States (R. 155-6). Commencing on

January 1, 1942, the Territory attempted to impose a tax upon sales to the United States (R. 156). A notice of the change in administrative practice was advertised for ten days, beginning December 31, 1941, the notice stating that such sales had previously been "exempt" (R. 167-168). At the same time, the Territory purported to increase the tax on sales to post exchanges from ¼ of 1% to 1½% (R. 156-7). The rate was stated by the Territory to have been increased at that time because it had been determined that post exchanges were instrumentalities of the United States although no evidence was adduced showing a basis for this change (R. 160, 162-3).

On May 2, 1944, appellee issued "First Notices of Proposed Additional Assessment of Gross Income Tax" for the indicated periods, increasing the tax of appellant as follows:

October 1 to December 31, 1942

Business Activity	Additional Amt. Taxable	Rate	Additional Tax	
Retail Sales Post Exchanges	$ 49,602.24	1½%	$ 744.03	
Retail Sales Ships' Service Stores	81,383.69	1½%	1,220.76	
Retail Sales Other Federal Sales	2,120.40	1½%	31.81	$ 1,996.60

January 1 to December 31, 1943

Retail Sales Post Exchanges	$155,266.67	1½%	$2,329.00	
Retail Sales Ships' Service Stores	291,044.42	1½%	4,365.67	
Retail Sales Other Federal Sales	440.67	1½%	6.61	$ 6,701.28

January 1 to March 31, 1944

Retail Sales Post Exchanges	$ 33,444.20	1½%	$ 501.66	
Retail Sales Ships' Service Stores	81,036.44	1½%	1,215.55	
Retail Sales Other Federal Sales	723.99	1½%	10.86	$ 1,728.07
Total Tax.....				$10,425.95

(R. 21.)

All of said sales were reported by appellant on his returns, but the income therefrom was claimed as exempt as derived from sales to the United States and its post exchanges and ships' service stores.[1] Moreover, appellant, on his returns, classified the

[1]Wherever "post exchanges" is used herein, it is meant to include ships' service stores in accordance with the stipulation of the parties hereto (R. 25).

sales to post exchanges as wholesale sales, taxable (if subject to tax) at the rate of ¼ of 1%. Appellee disallowed the claimed exemption. In addition, appellee disallowed the wholesale classification of sales to post exchanges, and reclassified the same as retail sales, taxable at the rate of 1½% (R. 22).

On May 15, 1944, appellant paid, under protest, the sum of $10,425.95 so assessed (R. 22); the chief grounds of protest set forth being as follows:

1. That gross income derived from said sales to the United States and its post exchanges is not taxable under the provisions of the General Excise Tax Law;

2. That if taxable under said law, such tax is in violation of the Organic Act of the Territory of Hawaii and the Constitution of the United States;

3. If the proceeds of sales to post exchanges can lawfully be taxed, the rate thereon cannot exceed ¼ of 1% (R. 12-14).

The trial court held that under Section 3 of the General Excise Tax Law the Legislature did not intend to impose a tax upon gross proceeds of, or gross income from federal sales, and rendered judgment accordingly for full recovery of the tax paid (R. 205). On appeal, the Territorial Supreme Court held that the Legislature did intend to tax such sales and construed the statute as one imposing a tax on the gross proceeds of sales to the United States and its agencies and instrumentalities. Further, it held that the Legislature had power to impose such a tax, and that the taxation on account of sales to post exchanges at

a higher rate than on account of sales to other retailers for resale does not constitute discrimination. Accordingly, it reversed the judgment of the trial court and remanded the case for a new trial (R. 191). Upon retrial, the cause was submitted on the record of the prior trial, and the court found for defendant in accordance with the decision of the Territorial Supreme Court (R. 107). Upon appeal to the Territorial Supreme Court by appellant, that court affirmed the judgment below (R. 189). From that judgment this appeal is taken (R. 259).

QUESTIONS OF LAW INVOLVED.

1. Can the Territory of Hawaii lawfully impose a tax on the gross proceeds of sales to the United States, its agencies or instrumentalities?

2. Assuming, without admitting, that the answer to the first question is in the affirmative, can the Territory of Hawaii lawfully impose a tax on the wholesaler at a higher rate on the gross receipts from sales to post exchanges for resale than on the gross receipts from sales by the same wholesaler to other retail merchants for resale?

STATUTES INVOLVED.

The applicable provisions of said General Excise Tax Law (Act 141 [Ser. A-44] Session Laws of Hawaii 1935), as amended, are as follows:

"Section 1. *Definitions.* When used in this Act, unless otherwise required by the context:

* * * * * * *

(10) 'Wholesaler' or 'jobber' shall apply only to a person doing a regularly organized wholesale or jobbing business, known to the trade as such, and only with respect to the following sales: (a) sales, to a licensed retail merchant or jobber, for purposes of resale; * * *

'Wholesaler' or 'jobber' shall mean a person, or a definitely organized division thereof definitely organized to render and rendering a general distribution service which buys and maintains at his or its place of business a stock or lines of merchandise which he or it distributes; and which, through salesmen, advertising or sales promotion devices, sells to licensed retailers, or to institutional, or licensed commercial or industrial users, in wholesale quantities and at wholesale rates.

* * * * * * *

(12) 'Retail' means the sale of tangible personal property, other than by a wholesaler as such within the definition of this Act, for consumption or use by the purchaser and not for resale.

(13) 'Retailer' shall mean any person who sells, other than as a wholesaler within the definition of this Act, tangible personal property for consumption or use by the purchaser and not for resale.

* * * * * * *

Section 2. *Imposition of tax; rates.*[2] 1. There

[2]Commencing July 1, 1939 all 1¼% rates were raised to 1½% by order of the Governor (see subsection III relating to increase or decrease of rates; by Act 111 S.L. 1947, effective July 1, 1947, the 1½% rate was raised to 2½%, and the ¼% rate was raised to 1%).

is hereby levied and shall be assessed and collected annually privilege taxes against the persons on account of their business and other activities in this Territory measured by the application of rates against values, gross proceeds of sales or gross income, as the case may be as follows:

* * * * * * *

B. *Tax on retailers, wholesalers and producers.* (1) Upon every person engaging or continuing within this Territory in the business of selling any tangible personal property whatsoever (not including, however, bonds or other evidence of indebtedness or stocks) there is likewise hereby levied, and shall be assessed and collected, a tax equivalent to one and one-quarter (1¼) per cent of the gross proceeds of sales of the business; provided, however, that in the case of a wholesaler or producer, the tax shall be equal to one-quarter (¼) of one per cent of the gross proceeds of sales of the business.

(2) Provided, that gross proceeds of sales of tangible property in interstate and foreign commerce shall constitute a part of the measure of the tax imposed on retailers and wholesalers, to the extent, under the conditions and in accordance with the provisions of the Constitution of the United States and the Acts of the Congress of the United States which may be now in force or may be hereafter adopted.

* * * * * * *

H. *Tax on other business.* Upon every person engaging or continuing within this Territory in any business, trade, activity, occupation, or calling not included in the preceding subsections or any other provisions of this Act, there

is likewise hereby levied and shall be assessed and collected, a tax equal to one and one-quarter (1¼) per cent of the gross income thereof. This subsection shall apply to the gross income of persons taxable under other subsections hereof not derived from the exercise of privileges taxable thereunder.

* * * * * * *

Section 3. *Interstate and foreign commerce. Federal agencies.* In computing the amounts of any tax imposed under this Act, there shall be excepted from the gross proceeds of sales or gross income, so much thereof as is derived from sales of tangible property in interstate and foreign commerce, which under the Constitution of the United States, the Territory of Hawaii is, or may hereafter be, prohibited from taxing, or is derived from any sales made to the United States government, its departments or agencies, which is, or may hereafter be, exempted from taxation under the Constitution of the United States or the Organic Act of the Territory; provided, however, that if and when the Congress of the United States shall permit the Territory of Hawaii to impose a privilege tax upon gross proceeds of sales or gross income derived from sales of tangible personal property in interstate and foreign commerce, or from sales made to the United States government, its departments or agencies, in either such event the exceptions and exemptions by this section provided, shall not apply.

* * * * * * *

Section 21. *Licenses; penalty for failure to secure.* Any person who shall have a gross income or gross proceeds of sales upon which a privilege tax is imposed by this Act, as a condition

precedent to engaging or continuing in such business, shall in writing apply for and obtain from the tax commissioner, upon payment of the sum of one dollar ($1.00) a license to engage in and to conduct such business for the current tax year, upon condition that he shall pay the taxes accruing to the Territory under the provisions of this Act, and he shall thereby be duly licensed to engage in and conduct such business. Said license shall be renewed annually and shall expire on the thirty-first day of December next succeeding the date of its issuance. Licenses and applications therefor shall be in such form as the commissioner shall prescribe, except that where the licensee is engaged in two or more forms of business of different classification, the license shall so state on its face. Any person who may lawfully be required by the Territory, and who is required by this Act, to secure a license as a condition precedent to engaging or continuing in any business subject to taxation under this Act, who shall engage or continue in such business without securing such license in conformity with this Act, shall be guilty of a misdemeanor; and any director, president, secretary or treasurer of a corporation who permits, aids or abets such corporation to engage or continue in business without securing a license in conformity with this Act, shall likewise be guilty of a misdemeanor; the penalty for such misdemeanor shall be that prescribed by section 19 for individuals, corporations or officers of corporations, as the case may be, for violation of said section 19."

SPECIFICATION OF ERRORS RELIED ON.

The Supreme Court of the Territory of Hawaii erred:

(1) In affirming the judgment of the Circuit Court, First Judicial Circuit, Territory of Hawaii, that the appellant take nothing by his complaint and dismissing the action, and in failing to set aside the judgment of said Circuit Court.

(2) In holding that the General Excise Tax Law imposing a tax on the gross proceeds of sales of appellant to the United States Government and its post exchanges, does not levy a burden upon or interfere with federal activities.

(3) In failing to hold that the General Excise Tax Law, including the gross receipts from sales to the United States, its agencies or instrumentalities, within the measure of tax, is a tax on the United States which is within the prohibition of the rule against the taxation of the sovereign.

(4) In failing to hold that the tax as so imposed is a direct burden on the Federal Government in the exercise of its essential governmental power of raising and supporting armies and of providing and maintaining a navy, and that said tax, therefore, violates Article I, Section 8, Clauses 12 and 13, of the Constitution of the United States.

(5) In holding that such tax had only an economic effect upon the United States Government, its departments and agencies, which economic effect is indirect and does not constitute the tax an invalid burden upon or interference with federal activities.

(6) In holding that the imposition of said tax was and is within the power of the Legislature of the Territory of Hawaii under Section 55 of the Hawaiian Organic Act and in violation of Article I, Section 8, Clause 12 or 13, of the Fifth Amendment of the Constitution of the United States.

(7) In failing to hold that said tax violates the Fifth Amendment of the Constitution of the United States in that it constitutes a tax on the privilege of doing business with the United States, its agencies or instrumentalities.

(8) In holding that said tax does not violate Section 55 of the Hawaiian Organic Act in that it imposes a direct tax on the privilege of doing business with the United States, which is a subject beyond the legislative power of the Territory of Hawaii in that it is not a rightful subject of legislation and in that it is inconsistent with the Constitution and laws of the United States.

(9) In holding that the rate of tax imposed by said General Excise Tax Law upon all gross proceeds of sales to the Federal Government and agencies thereof was at the rate of 1½% irre-

spective of whether such goods were intended to be or were resold by the purchasers.

(10) In holding that the tax imposed by said law upon the gross proceeds of sales to post exchanges for the purpose of resale was at a rate higher than ¼ of 1%.

(11) In holding that said tax law required the Tax Commissioner to include in the measure of tax the proceeds of sales to the United States and its agencies at the rate of 1½%.

(12) In holding that a tax on sales to post exchanges at a higher rate than on sales to other retailers is not prohibited as an indirect way of doing what cannot be done directly under the Constitution of the United States.

(13) In holding that the classifications made by the Legislature between post exchanges and licensed retailers are natural and reasonable and not discriminatory against appellant or the Federal Government or its instrumentalities.

(14) In holding that a tax upon appellant at a higher rate on account of its sales to post exchanges for resale than upon its sales to licensed retailers for resale was not discriminatory against appellant or the Federal Government or its instrumentalities.

(15) In holding that the Tax Commissioner did not discriminate in the administration of the tax law against appellant or the Federal Government or its instrumentalities.

(16) In holding that appellant is not entitled to recover the gross income taxes paid by him under protest, or any part thereof, for the reason that the Legislature is without power to impose a tax upon the proceeds of gross sales to the United States or its instrumentalities, and, for the further reason that in no event can the Legislature impose a tax upon the gross proceeds of sales to post exchanges for resale at a higher rate than that imposed on account of sales to other retailers for resale.

(17) In failing to enter a judgment in favor of appellant that he recover gross income taxes paid under protest in accordance with his prayer as set forth in the complaint.

SUMMARY OF ARGUMENT.

A—The Territory of Hawaii cannot lawfully impose a tax on the gross receipts from sales to the United States or its agencies or instrumentalities.

1. The Territory of Hawaii is not a sovereign government with inherent power to impose taxes, but derives its power to tax from the United States.

2. Congress has never delegated to the Territory of Hawaii the power to tax the United States or its agencies or instrumentalities.

3. A statute which includes the gross receipts from sales to the United States or its agencies

or instrumentalities, within the measure of the tax, is a tax on the United States.

4. The Panhandle line of cases has not been overruled in so far as it holds that a tax on account of sales to the United States is unconstitutional.

B—The Territory of Hawaii cannot lawfully impose a tax at a higher rate with respect to sales to post exchanges than with respect to sales to other retail merchants for resale.

1. The General Excise Tax Law properly construed does not impose a tax at a higher rate with respect to sales to post exchanges than with respect to sales to other retailers.

2. Assuming that the General Excise Tax Law requires the imposition of a higher rate with respect to sales to post exchanges than with respect to sales to other merchants, then said Act is unconstitutional.

ARGUMENT.

A. THE TERRITORY OF HAWAII CANNOT LAWFULLY IMPOSE A TAX ON THE GROSS RECEIPTS FROM SALES TO THE UNITED STATES OR ITS AGENCIES OR INSTRUMENTALITIES.

1. The Territory of Hawaii is not a sovereign government with inherent power to impose taxes, but derives its power to tax from the United States.

The right of the Territory to tax the gross receipts from sales to the United States and to its agencies and instrumentalities is upheld by the Supreme Court of

the Territory by analogy to comparatively recent cases, which, it is claimed, support the right of states to impose such taxes.

No taxes were attempted to be imposed by the Territory with regard to sales to the United States, its agencies, or instrumentalities until after December 31, 1941. However, assessments were made with respect to the proceeds of construction contracts with the United States. Sales to post exchanges were sought to be taxed at the rate of ¼ of 1% during such time.[3] It was stated by the Deputy Tax Commissioner in charge of gross income taxes to have been done under the theory that post exchanges were not agencies or instrumentalities of the United States. The exemption of sales to the United States, prior to January 1, 1942, arose out of the fact that since the enactment of the General Excise Tax Law in 1935, and until the end of 1941, the proper officers, charged with the duty of administering taxes in the Territory, by and with the advice of the legal officers of the Territory, recognized that the Territory was without constitutional power to impose a tax with regard to such sales. At that time it was generally recognized throughout the country in all the courts, including the Supreme Court of the United States, that under the holdings in *Graves v. Texas Co.*,[4] *Panhandle Oil Co. v. Mississippi ex rel. Knox*,[5] and *Indian Motorcycle Co. v.*

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[3]The legality of such tax appears not to have been judicially determined.

[4]298 U.S. 393, 80 L. ed. 1236 (1936).

[5]277 U.S. 218, 72 L. ed. 857 (1928).

United States,[6] states were without power to impose taxes on the gross receipts from sales to the United States or its agencies or instrumentalities. The generality of the holdings in these cases has been somewhat limited by later decisions of the United States Supreme Court.[7] However, the direct holding of the Supreme Court that no tax can be imposed by a state upon the gross receipts from sales to the United States or its agencies or instrumentalities is still preserved. It is our contention that the court below proceeds on a false assumption when it argues, by analogy from cases involving states' right to tax, that the Territory has a similar right to tax gross receipts from sales to the United States and its agencies and instrumentalities.

In the first place, the Supreme Court has not held that states may tax with regard to sales to the United States and its agencies and instrumentalities. The cases relied on and cited by the court do not so hold. In *James v. Dravo Contracting Co., supra,* the Supreme Court said that the *Panhandle* case, *supra,* and *Graves v. Texas Co., supra,* can be distinguished and must be held limited to their facts; and, in *Alabama v. King & Boozer, supra,* the Supreme Court founded its holding on the fact that the purchaser was not the United States or its agency or instrumentality.[8]

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[6]283 U.S. 570, 75 L. ed. 1277 (1931). These cases are hereinafter sometimes refered to as the *Panhandle* line of cases.

[7]*James v. Dravo Contracting Co.*, 302 U.S. 134, 82 L. ed. 155 (1937); *Alabama v. King & Boozer*, 314 U.S. 1, 86 L. ed. 3 (1941); *Curry v. United States*, 314 U.S. 14, 86 L. ed. 9 (1941).

[8]These cases are discussed more fully *infra.*

In the second place, the Territorial Supreme Court loses sight of the inherent difference in the fundamental nature of states and territories. By the Constitution (Amendment X) all the powers not delegated to the United States by the Constitution or prohibited by it to the states are reserved to the states respectively or to the people. Accordingly, therefore, all sovereign power is in the states and the people. All powers not expressly given to the United States and not forbidden by the Constitution to the states remain in the states and the people.

The same, however, is not true of territories, as the Supreme Court said in *Snow v. United States*[9]:

> "The government of the Territories of the United States belongs, primarily, to Congress; and, secondarily, to such agencies as Congress may establish for that purpose. During the term of the pupilage as Territories, they are mere dependencies of the United States. Their people do not constitute a sovereign power. All political authority exercised therein is derived from the General Government.
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> * * * * * * *
>
> * * * Strictly speaking, there is no sovereignty in a Territory of the United States but that of the United States itself."

Again, in *First Nat. Bank of Brunswick v. Yankton,*[10] the court said:

> "* * * The Territories are but political subdivisions of the outlying dominion of the United

[9] 85 U.S. 317, 21 L. ed. 784, 785 (1873).
[10] 101 U.S. 129, 25 L. ed. 1046, 1047 (1880).

States. They bear much the same relation to the General Government that counties do to the States, and Congress may legislate for them as States do for their respective municipal organizations. The organic law of a Territory takes the place of a constitution, as the fundamental law of the local government. It is obligatory on and binds the territorial authorities; but Congress is supreme and, for the purposes of this department of its governmental authority, has all the powers of the People of the United States, except such as have been expressly or by implication reserved in the prohibitions of the Constitution.
* * *
* * * In other words, it [Congress] has full and complete legislative authority over the People of the Territories and all the departments of the territorial governments. It may do for the Territories what the People, under the Constitution of the United States, may do for the States."

To the same effect are the following cases:

Late Corporation of Latter-Day Saints v. United States, 136 U.S. 1, 34 L. ed. 478 (1890);

United States v. Winans, 198 U.S. 371, 49 L. ed. 1089, 1093 (1905);

De Lima v. Bidwell, 182 U.S. 1, 45 L. ed. 1041, 1056 (1901);

Downes v. Bidwell, 182 U.S. 244, 45 L. ed. 1088, 1099 (1901);

Assessor v. Com. Cable Co., 16 Haw. 396 (1905);

Christianson v. King County, 239 U.S. 356, 60 L. ed. 327, 331 (1915).

And the same has been recognized by the Supreme Court of the Territory of Hawaii in *Makainai v. Goo Wan Hoy*:[11]

> "* * * The state, being an independent sovereignty within its sphere, makes its own constitution and laws, creates its own courts and fixes their jurisdiction; while a territory, being a political dependency under the absolute control and dominion of Congress, its organic law is made by Congress and its courts and their jurisdiction and procedure is defined by the same power. First National Bank v. Yankton, 101 U.S. 129; Patterson v. Gile, 1 Colo. 200."

2. Congress has never delegated to the Territory of Hawaii the power to tax the United States or its agencies or instrumentalities.

The basic grant of power to the Territory giving it the right to impose taxes of any kind is contained in Section 55 of the Hawaiian Organic Act as amended (April 30, 1900, 31 Statutes at Large, 141, Ch. 339), and is contained in the following words of said section:

> "That the legislative power of the Territory shall extend to all rightful subjects of legislation not inconsistent with the Constitution and laws of the United States locally applicable."

Under this broad legislative power, the Territory has not purported to tax the United States or its agencies or instrumentalities, nor has it attempted to tax the privilege of making sales to the United States, its agencies or instrumentalities, until January 1, 1942.

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[11]14 Haw. 607, 609 (1903).

We contend that this interpretation of the constitutional taxing power of the Territory as administered by the Territory until the end of 1941 is correct, and that there is no basis for any change in 1942 in the absence of any congressional action consenting to such tax or even of action by the Legislature of the Territory of Hawaii.

Congress has not since 1900 enlarged the legislative power of the Territory, and for over forty years the Territory has recognized that it did not have the power to tax with regard to the proceeds of sales here in question. The Organic Act, which is in effect the Constitution of the Territory, must be interpreted in the light of the conditions under which it was enacted. No different interpretation can be given to it by reason of a changed concept with regard to states' powers that arises by reason of later judicial interpretation, and does not arise out of additional grants of power. In the case of states, states do have all sovereign power, and when the courts change their decisions with regard to states' powers they are merely interpreting and defining what that sovereign power consists of and to what extent the sovereign power of the states was cut into and limited by the Constitution in favor of the United States.

In the case, however, of the Territory's power to tax, court decisions relative to the states have no application because the territories have only such powers as are given them by Congress and the power that is given them by Congress depends upon what Congress thought it was granting at the time of the enactment

of the power granting act. The Organic Act of the Territory of Hawaii is the Constitution of the Territory, and as such must be interpreted in the light of its meaning and intent when Congress adopted it. Such is the recognized rule with regard to a constitution or fundamental grant of power to a government. In the case of *Dred Scott v. Sanford,*[12] the question before the court was whether negroes were citizens. The court found that they were not included and were not intended to be included under the word "citizens" in the Constitution and could, therefore, claim none of the rights and privileges which that instrument provides for and secures to the citizens of the United States. On the contrary, they were at that time considered as a subordinate and inferior class of beings, who had been subjugated by the dominant race, and whether emancipated or not, yet remained subject to their authority, and had no rights or privileges but such as those who held the power and the government might choose to grant them. The court said at page 700:

> "It is not the province of the court to decide upon the justice or injustice, the policy or impolicy of these laws. The decision of that question belonged to the political or law-making power; to those who formed the sovereignty and framed the Constitution. The duty of the court is to interpret the instrument they have framed, with the best lights we can obtain on the subject, and to administer it as we find it, according to its true intent and meaning when it was adopted."

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[12]60 U.S. 393, 15 L. ed. 691 (1857).

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"No one, we presume, supposes that any change in public opinion or feeling, in relation to this unfortunate race, in the civilized nations of Europe or in this country, should induce the court to give to the words of the Constitution a more liberal construction in their favor than they were intended to bear when the instrument was framed and adopted. Such an argument would be altogether inadmissible in any tribunal called on to interpret it. If any of its provisions are deemed unjust, there is a mode prescribed in the instrument itself by which it may be amended; but while it remains unaltered, it must be construed now as it was understood at the time of its adoption. It is not only the same in words, but the same in meaning, and delegates the same powers to the government, and reserves and secures the same rights and privileges to the citizen; and as long as it continues to exist in its present form, it speaks not only in the same words, but with the same meaning and intent with which it spoke when it came from the hands of its framers, and was voted on and adopted by the people of the United States. Any other rule of construction would abrogate the judicial character of this court, and make it the mere reflex of the popular opinion or passion of the day. This court was not created by the Constitution for such purposes. Higher and graver trusts have been confided to it, and it must not falter in the path of duty."

Again, in *South Carolina v. United States*:[13]

"The Constitution is a written instrument. As such its meaning does not alter. That which it

[13]199 U.S. 437, 50 L. ed. 261, 264 (1905).

meant when adopted, it means now. Being a grant of powers to a government, its language is general; and, as changes come in social and political life, it embraces in its grasp all new conditions which are within the scope of the powers in terms conferred. In other words, while the powers granted do not change, they apply from generation to generation to all things to which they are in their nature applicable. This in no manner abridges the fact of its changeless nature and meaning. Those things which are within its grants of power, as those grants were understood when made, are still within them; and those things not within them remain still excluded. As said by Mr. Chief Justice Taney in Scott v. Sandford, 19 How. 393, 426, 15 L. ed. 691, 709:

'It is not only the same in words, but the same in meaning, and delegates the same powers to the government, and reserves and secures the same rights and privileges to the citizen; and as long as it continues to exist in its present form, it speaks not only in the same words, but with the same meaning and intent with which it spoke when it came from the hands of its framers, and was voted on and adopted by the people of the United States. Any other rule of construction would abrogate the judicial character of this court, and make it the mere reflex of the popular opinion or passion of the day.' ''

The question immediately arises as to what Congress thought it was delegating to the Territory at the time of the passage of the Organic Act. A general

statement of the law in this respect is set out in *Domenech v. National City Bank*:[14]

> "* * * Puerto Rico, an island possession like a territory, is an agency of the federal government, having no independent sovereignty comparable to that of a state in virtue of which taxes may be levied. Authority to tax must be derived from the United States. But like a state, though for a different reason, such an agency may not tax a federal instrumentality. A state, though a sovereign, is precluded from so doing because the Constitution requires that there be no interference by a state with the powers granted to the federal government. A territory or a possession may not do so because the dependency may not tax its sovereign. True the Congress may consent to such taxation; but the grant to the Island of a general power to tax should not be construed as a consent. Nothing less than an act of Congress clearly and explicitly conferring the privilege will suffice. * * *"

In *Posadas v. National City Bank*,[15] the court referred to the controlling rule of the *Domenech* case that "a dependency may not tax the sovereign."

Congress has not specifically consented to any tax by the Territory on sales to the United States or its agencies or instrumentalities.

In *Puerto Rico v. Shell Co.*,[16] the court, discussing the *Domenech* case, said that it there held that the grant to the Territory of the general power to tax

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[14]294 U.S. 199, 79 L. ed. 857, 861 (1935).
[15]296 U.S. 497, 80 L. ed. 351, 354 (1936).
[16]302 U.S. 253, 82 L. ed. 235, 247 (1937).

did not constitute consent on the part of Congress that a tax not authorized by the statute in question could be laid.

In granting legislative power to the Territory, including the general power to tax, it is neither desirable nor probable that Congress would leave the limits of the power to tax as vague and undefined as would result from having the applicability of any tax vary with every judicial interpretation and dictum of the Supreme Court. As was stated in *Helvering v. Griffiths*:[17]

> "* * * Such an intention [to have the coverage of a tax vary with judicial changes] would be a serious departure from the usual policy of Congress to provide the taxpayers and tax-gatherers with a practical basis for the timely settlement of questions of taxation arising each year. * * *"

Similarly, in *E. V. Parker v. Motor Boat Sales, Inc.*:[18]

> "* * * An interpretation [or a jurisdictional proviso of a statute] which would enlarge or contract the effect of the proviso in accordance with whether this Court rejected or reaffirmed the constitutional basis of the Jensen and its companion cases cannot be acceptable. * * *
>
> * * * Without affirming or rejecting the *constitutional*[19] implications of those cases, we accept them as the measure by which Congress intended to mark the scope of the Act they brought into existence."

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[17]318 U.S. 371, 87 L. ed. 843, 861 (1943).
[18]314 U.S. 244, 249, 86 L. ed. 184 (1941).
[19]Italics the court's.

The *Griffiths* case stands squarely for the proposition that Congress may and does incorporate current constitutional rules into its legislation by implication; that the courts will support such incorporation and that the policy of stability of a law militates in favor of such incorporation and against the inference of vacillating and undefined contraction of the tax with subsequent varying decisions.

3. A statute which includes the gross receipts from sales to the United States or its agencies or instrumentalities, within the measure of the tax, is a tax on the United States.

With regard to the power of the Territory to impose a tax on account of sales to the United States, the court below, in its majority opinion, stated: "A tax imposed by a non-federal political agency, however reasonable, universal and non-discriminating, the legal effect of which is to lay a direct and immediate tax upon the instrumentalities of the United States, is within the implied power of the Constitution of the United States against laying a burden upon or interfering with federal activities, even though imposed under the guise of an excise tax. A nondiscriminating territorial excise tax, measured by the application of rates against values, gross proceeds of sales or gross income, as the case may be, is not within the constitutional prohibition merely because in its incidence it might indirectly reach a federal instrumentality." (R. 193-4). "The tax the legality of which is in question herein was assessed for the year 1942. The *King & Boozer* case was decided in November, 1941. And the rationale of the *King & Boozer* case applies without

the necessity of further legislation on the subject." (R. 195).

The minority opinion, concurring in part, holds that the effect of the cases of *James v. Dravo Contracting Co., supra, Alabama v. King & Boozer, supra, Curry v. United States, supra, Penn Dairies v. Milk Control Com.*,[20] is that from the time of the enactment of the General Excise Tax Law, the meaning of the Constitution, as construed by the Supreme Court of the United States, underwent a complete change with regard to the exemption from nondiscriminatory taxation by a state of federal sales, so that after 1941 such sales were held to be rightful subjects of nondiscriminatory taxation and no longer exempt therefrom under the Constitution. This construction was stated to be decisive in the minority opinion.

Both the majority and minority opinions agree that the *Panhandle* line of cases constituted the controlling rule of 1935 with regard to the taxability of sales to the United States. Both agree, likewise, that a state, and, therefore, a territory, cannot directly burden the activities of the Federal Government. Both, however, fail to see that the direct holding of the *Panhandle* line of cases that a state may not tax the proceeds of sales to the Federal Government still is controlling because such cases have not been overruled in their direct holding that a state may not impose a tax on sales to the United States, and for the further reason that a tax on sales to the United States is a direct interference with the government activity of purchas-

[20] 318 U.S. 261, 87 L. ed. 748 (1943).

ing what it requires in the exercise of its governmental functions and is, therefore, in violation of the Federal Government's implied immunity from tax under the Constitution.

4. The Panhandle line of cases has not been overruled in so far as it holds that a tax on account of sales to the United States is unconstitutional.

The *Panhandle Oil* case *supra* involved a privilege tax on all persons engaged in distributing gasoline, measured on a per gallon basis. The issue was the right to collect such tax on account of sales of gasoline to the United States. The court held that the state may not burden or interfere with the exertion of the national power or make it a source of revenue or tax the means used in performance of federal functions; that the right of the United States to make purchases is derived from the Constitution; that the petitioner's right to make sales to the United States is not given by the state and does not depend on state law; that it results from the authority of the national government under the Constitution to choose its own means and sources of supply; that while the state may impose a charge on the dealer for the privilege of carrying on a trade that is subject to the power of the state, it may not lay a tax on the transactions by which the United States secures the things desired for its governmental purposes; that it is immaterial that the seller is required to report the sales and make the payments thereon; that the sale and purchase constitute a transaction on which the tax is measured and on which the burden rests; that the amount of money claimed

by the state rises and falls precisely as does the quantity of gasoline secured by the Government; that the necessary operation of the enactment is directly to retard, impede and burden the exertion by the United States of its constitutional power of operating a fleet; and that to use the number of gallons sold to the United States as a measure of a privilege tax is to tax the sale itself.

In *Indian Motorcycle Co. v. United States, supra,* there was involved a United States tax on motorcycles sold to a municipal government. In holding such sales to be immune from tax in order to preserve our constitutional system of dual government, the court quoted from the *Panhandle* case, *supra,* to the effect that the sale and purchase constitute a transaction by which the tax is measured and on which the burden rests.

In *Graves v. Texas Co., supra,* that principle was reiterated in a case involving a tax on storage of gasoline measured by withdrawals in which it was held that the storage was so essential to sale as to be a tax on the sale itself.

The court below held that these cases are no longer applicable to the present case because of the later holdings of the United States Supreme Court cited *supra.* It is appellant's contention that the United States Supreme Court recognized differences between the later cases limiting immunity from tax and the *Panhandle* line of cases, and that the *Panhandle* line of cases still controls in the present case. This is evident from statements made in each of said cases

showing that the transactions there involved have tax implications different from those arising out of the transaction of sale and purchase subjected to tax in the *Panhandle* line of cases.

In *James v. Dravo Contracting Co., supra,* there was involved a gross receipts tax on account of the proceeds of a contract with the United States. The court said of the tax that it was not on the Government, its property or officers, nor on an instrumentality of the United States; that it was nondiscriminatory, and was *not on a contract of the Government.*[21] The court said that the *Panhandle* and *Indian Motorcycle* cases may be distinguished and must be deemed to be limited to their particular facts. Obviously, the most particular fact of those cases to which the court had reference was that in the *Panhandle* line of cases, the tax was imposed on account of sales to the Government. With regard to direct sales to the Government that much of the case remains the law after the *James v. Dravo* case. The gist of the *Dravo* case is that the mere fact that the gross receipts tax on a contractor with the Government may increase the cost to the Government, nevertheless, that is not a direct enough burden on the Government to invalidate the tax.

In *Alabama v. King & Boozer, supra,* where a contractor was required to pay a tax on account of his purchases, the court said that the *Panhandle* line of cases were overruled in so far as they hold that a tax, the economic burden of which falls on the Govern-

[21] Emphasis supplied.

ment, may not constitutionally be imposed by a state. In other words, it is not merely the fact that the economic burden fell on the Government which invalidated the tax in the *Panhandle* line of cases, but primarily it was that the tax was on a transaction in which the Government is a party, so that the tax was directly imposed on an activity of the Federal Government. That this is the meaning of that case can be seen from the fact that the bulk of the decision in *Alabama v. King & Boozer* is concerned with showing that the legal effect of the transaction subject to tax was to obligate the contractor to pay for the lumber, and that it was the contractor that was the purchaser and not the United States. The transaction on account of which the tax was imposed was, therefore, between a seller of lumber and a purchaser who was a cost-plus contractor with the United States, but not an agency or instrumentality of the United States. Although the contractor was bound to deliver the lumber to the Government after the purchase and to be reimbursed, the court was of the opinion that this did not spell immunity because the contractors were, in a loose and general sense, acting for the United States. In its reasoning, this indicates that the court recognized that were the tax on a sale to the Government, or to a Government agency direct, the tax would not have been valid under the holdings of the *Panhandle* line of cases.

Curry v. United States, supra, likewise does not determine that sales to the United States are subject to tax. There was involved a use tax on materials pur-

chased by a cost-plus contractor and appropriated to its contract with the Government. The court pointed out that the contractor was not an agent or instrumentality of the Government, and that the tax only affects the Government as the economic burden is shifted to it through operation of a contract. The transactions involved in both the *King & Boozer* and *Curry* cases are a step further removed from the transaction involved in the *Panhandle* line of cases and the present case. In the case of cost-plus contractors in the *King & Boozer* and *Curry* cases, it is the purchase and use of materials by the contractor who is not the agent or instrumentality of the United States that is the subject matter of the case. In the *Panhandle* line of cases, as in the present case, it is the acquisition of property by the Government, in effect, that was taxed, even though the tax was laid on the seller.

The case of *Penn Dairies v. Milk Control Com., supra,* does not advance the Territory's case much further. In that case there was involved the validity of minimum price regulations of the state as applied to the sale of milk by a dealer to the United States. The court held in upholding a local law under the police power of the state that those who furnish supplies or render services are not agencies and do not perform governmental functions, and that, although the regulation imposes an economic burden on the Government, there is no greater impairment of a federal right than a tax on sales to contractors with the United States. The statement in that case, with regard to certain regulations of the War Department,

that they rest on the reasoning of the *Panhandle Oil* and like cases which were overruled as in *Alabama v. King & Boozer,* refers to the reasoning of those cases that a tax is invalid merely because the burden may be shifted to the United States. A reference back to the *King & Boozer* case will show that this is what the court meant. There the court said that the asserted right of one (referring to the Federal and State Governments as separate sovereign powers within the same territorial jurisdiction) to be free of taxation by the other does not spell immunity from paying the additional costs attributable to the taxation of those who furnish supplies to the Government and who have been granted no tax immunity, and that so far as a different view has prevailed, see *Panhandle* and *Graves* cases, we think it is no longer tenable.

In addition to these cases, there are a number of later cases in which the Supreme Court made statements showing that in each case it recognized that it was dealing with a transaction different than that subjected to tax in the *Panhandle* line of cases. In *Mayo v. United States,*[22] the court, in invalidating a tax on activities of the United States, said that they were not dealing, as in *Graves v. New York,*[23] with a tax on the salary of an employee of the Government, or, as in the *King & Boozer* case, with a tax on purchases of a supplier of the United States, or as in the *Penn Dairies* case, with price control of a contractor with the United Staes.

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[22]319 U.S. 441, 87 L. ed. 1504 (1943).
[23]306 U.S. 466, 83 L. ed. 927 (1939).

In *United States v. County of Allegheny,*[24] the court characterized the *Dravo* case as concerned with a tax on the benefits of a contractor from dealings with the United States, the *Graves* case as a tax on salaries received from it, and said of the *King & Boozer* case that the fact that materials were destined to be furnished to the Government does not exempt them from a sales tax imposed on the contractor's vendors.

A case which is much closer to the present case than the *King & Boozer* and *Curry* cases is that of *United States v. County of Allegheny, supra.* In that case there was in question the validity of an *ad valorem* tax imposed on a lessee of the Federal Government measured, in part, by property owned by the Government. This tax was held invalid as an undue interference with the Government's ownership of its property. This is but slightly different from the present case, which is an attempted interference with the Government's acquisition of property in the performance of its governmental functions. In this connection, also, it is interesting to note Mr. Justice Roberts' comment in the minority holding at page 1223 to the effect that the doctrine of immunity from consequent burden on the Government is being reimported into our jurisdiction. However, it is not necessary to rely on the doctrine of immunity from consequent burden on the Government, because, in the present case, the burden is directly on the Government and the tax is directly on a governmental activity.

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[24]322 U.S. 174, 88 L. ed. 1209 (1944).

As was said in the *Indian Motorcycle Co.* case, the sale and purchase constitute a single transaction in which the purchaser is an essential part. No sale is possible without a purchaser and any tax arising out of that transaction is a tax on the purchaser.

In the *Panhandle Oil* case, the court said that the right of the United States to make purchases is derived from the Constitution, and the taxpayer's right to make sales to the United States is not given by the states, nor dependent upon state laws, but results from the authority of the national government under the Constitution to choose its own means and source of supply. While the state may impose a charge for the privilege of carrying on trade, no tax may be laid on transactions by which the United States secures the things desired for Government purposes. Such a tax directly retards, impedes and burdens the execution by the United States of its constitutional powers.

In *McLeod v. Dillworth Co.*,[25] the court characterized a sales tax as a tax on the freedom of purchase; a freedom which war-time restrictions served to emphasize; and, in *Freeman v. Hewitt*,[26] in discussing the Indiana Gross Income Tax, on which the Territorial General Excise Tax was modeled, said that a tax on the sale itself is no different than a tax on gross receipts, and that a tax on gross receipts is a direct imposition on the freedom of commercial flow of goods.

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[25]322 U.S. 327, 330, 88 L. ed. 1305, 1307 (1944).
[26]329 U.S. 249, 91 L. ed. (Adv. Sheets) 205, 210 (1946).

In *Richfield Oil Corp. v. State Board of Eq.*,[27] where there was involved the validity of a tax on exports, the court said that the issue turns not on the characterization which the state gives the tax, but on its operation and effect. The incident giving rise to the tax was the passage of title and the completion of sale, which is a part of the export process.

Incidentally, it is apparent now, after the case of *United States v. County of Allegheny, supra,* that it is not necessary that the tax be imposed on the Government itself in order that the transaction in which the Government is a party shall be immune, and that a tax is not necessarily valid if laid upon a third party even thought the burden falls on the Government.

The test of validity of state taxes on account of transactions with the Federal Government, seems to be the degree of directness of the imposition of the tax; that is, if the tax is imposed against the Government or its instrumentalities or agencies, or against its officers as such, or upon its property, or upon a contract of the Government, or upon its acquisition of property, then the interference with the functions of the Federal Government is too direct an interference with its sovereignty. If, on the other hand, the tax is imposed upon the proceeds of a contract with the United States, as in *James v. Dravo Contracting Co.;* upon the purchases of a supplier of the United States, as in the *King & Boozer* case; or on the use of materials purchased by a contractor with the United

[27]329 U.S. 69, 91 L. ed. (Adv. Sheets) 123, 131, 132 (1946).

States which are appropriated by the contractor to the contract with the United States, as in *Curry v. United States;* or if control is exercised over a contractor with the United States, as in the *Penn Dairies* case; then, the interference with a federal function is not so direct as to constitute an undue interference with the sovereignty of the United States.

An examination of the fundamental basis for federal immunity from state taxation shows that there is not the same reason to cut down on the immunity in the cases of territories as there is in the case of states. The reason for whittling away the doctrine of federal immunity from state taxation is the importance of preserving the sovereignty of states which under the Constitution is reserved to the states. As pointed out above, there is no sovereignty in the Territory and the basic reason for allowing some interference with federal functions disappears. The court, in cases in which the imposition of a state tax was justified even though it burdened the Federal Government, stated that this was necessary in order to preserve the dual sovereignty provided for by the Constitution.

In *Union Pacific R. R. Co. v. Peniston,*[28] the nature of the dual sovereignty contemplated by the Constitution was discussed. The court said, in part:

> "That the taxing power of a State is one of its attributes of sovereignty; that it exists independently of the Constitution of the United States, and underived from that instrument; and

[28] 85 U.S. 5, 21 L. ed. 787, 791 (1873).

that it may be exercised to an unlimited extent upon all property, trades, business and avocations existing or carried on within the territorial boundaries of the State, except so far as it has been surrendered to the Federal Government, either expressly or by necessary implication, are propositions that have often been asserted by this court. And in thus acknowledging the extent of the power to tax belonging to the States, we have declared that it is indispensable to their continued existence. No one ever doubted that before the adoption of the Constitution of the United States, each of the States possessed unlimited power to tax, either directly or indirectly, all persons and property within their jurisdiction, alike by taxes on polls, or duties on internal production, manufacture or use, except so far as such taxation was inconsistent with certain treaties which had been made. * * *

There are, we admit, certain subjects of taxation which are withdrawn from the power of the States, not by any direct or express provision of the Federal Constitution, but by what may be regarded as its necessary implications. They grow out of our complex system of government, and out of the fact that the authority of the National Government is legitimately exercised within the States. While it is true *that* government cannot exercise its power of taxation so as to destroy the state governments, or embarrass their lawful action, it is equally true that the States may not levy taxes the direct effect of which shall be to hinder the exercise of any powers which belong to the National Government. The Constitution

contemplates that none of those powers may be restrained by state legislation. * * * The States are, and they must ever be, co-existent with the National Government. Neither may destroy the other. Hence the Federal Constitution must receive a practical construction. Its limitations and its implied prohibitions must not be extended so far as to destroy the necessary powers of the States, or prevent their efficient exercise."

Again, in *Graves v. New York*,[29] the court said:

"So much of the burden of a nondiscriminatory general tax upon the incomes of employees of a government, state or national, as may be passed on economically to that government, through the effect of the tax on the price level of labor or materials, is but the normal incident of the organization within the same territory of two governments, each possessing the taxing power. The burden, so far as it can be said to exist or to affect the government in any indirect or incidental way, is one which the Constitution presupposes, and hence it cannot rightly be deemed to be within an implied restriction upon the taxing power of the national and state governments which the Constitution has expressly granted to one and has confirmed to the other. The immunity is not one to be implied from the Constitution, because if allowed it would impose to an inadmissible extent a restriction on the taxing power which the Constitution has reserved to the state governments."

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[29]306 U.S. 466, 83 L. ed. 927, 937 (1939).

It is apparent from these extracts that it is necessary to permit states to interfere to some extent with federal powers by taxation because the states must co-exist with the national government and the power to tax is essential to the continued existence of states.

The court below appears to believe that because the states' power to tax transactions involving the United States has been expanded, the same thing has happened in the case of the Territory's right to tax. This, however, does not follow, since the expansion of the states' right to tax depends upon the existence of two sovereigns within the same field, each of which is entitled to tax, and each of which is entitled to be free from interference by the other, and the court has determined that the right to tax is, in some instances, a justifiable reason for some interference in the exercise of the sovereign rights of the other. No such problem, however, arises in the case of a territory which is not a sovereign and which derives all its powers from the Federal Government. Its right to tax, therefore, must be subservient to the sovereign's right to be free of any interference by its artificially created subsidiary except to the extent that it has given its consent to such a tax, or to such interference with the sovereign's powers and actions.

B. THE TERRITORY OF HAWAII CANNOT LAWFULLY IMPOSE A TAX AT A HIGHER RATE WITH RESPECT TO SALES TO POST EXCHANGES THAN WITH RESPECT TO SALES TO OTHER RETAIL MERCHANTS FOR RESALE.

Appellant contends that for the reasons set forth above, the Territory cannot lawfully impose a tax on the gross proceeds of sales to the United States or to any federal agency or instrumentality, including post exchanges. It is the further contention of appellant that in the event it is held that such taxes can validly be imposed, in no event can the gross proceeds of sales to post exchanges be taxed at more than ¼ of 1%, which is the rate imposed with respect to sales to other retailers for resale and not for consumption.

There seems to be no dispute as to the general principle of law that a state or territorial tax, measured by gross proceeds of sale, must be nondiscriminatory in so far as said agencies are concerned in order to be outside the constitutional prohibition.

The United States Supreme Court, in a number of cases in which state taxes imposed with regard to gross receipts from contracts with the United States have been held valid, has said that the tax must be nondiscriminatory in so far as the Federal Government is concerned. That is, even where the state is permitted to indirectly burden agencies of the Federal Government in order to permit the state to continue its existence through the exercise of its sovereign power to tax, the court has asserted that the burden on the Government must not be greater than

that on other taxpayers within the state. For example, in the *Dravo* case, supra, the court said:

> "* * * Respondent has no constitutional right to immunity from *nondiscriminatory*[30] local taxation and the mere fact that the tax in question burdens respondent is no defense. * * *"

Again, in the *King & Boozer* case, *supra,* the court said:

> "* * * So far as such a *nondiscriminatory*[30] state tax upon the contractor enters into the cost of the materials to the Government, that is but a normal incident of the organization within the same territory of two independent taxing sovereignties. * * *"

And again, in the *Penn Dairies* case, *supra,* the court said:

> "* * * and the mere fact that *nondiscriminatory*[30] taxation or regulation of the contractor imposes an increased economic burden on the government is no longer regarded as bringing the contractor within any implied immunity of the government from state taxation or regulation. * * *"

These cases, in laying down the general rule that there is no implied constitutional immunity of the Government and its agencies from nondiscriminatory state taxation upon persons dealing with them merely because the economic burden thereof may be shifted to the Government, by necessary implication must be taken to mean that there is an implied constitu-

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[30]Emphasis supplied.

tional immunity from discriminatory state taxation. It follows that any discriminatory tax directly impedes, retards and burdens the constitutional exercise of the powers of the Government in the performance of its functions, and is unconstitutional.

In determining that the Territory could impose a tax at the rate of 1½% on account of sales to post exchanges, the court below determined:

(1) That the statute required the imposition of the tax at 1½% rather than ¼ of 1% because appellant, with respect to sales to post exchanges, was not a wholesaler within the meaning of the Act;

(2) That the classification under which sales to post exchanges are taxed at a higher rate than sales to other retailers for resale, is a natural and reasonable classification of vendors, and, therefore, not discriminatory; and

(3) That factually no discrimination exists against sales to post exchanges.

With regard to the first determination, appellant contends that in so construing the General Excise Tax Law the court below has committed such manifest error and has so clearly departed from ordinary legal principles, and is so clearly wrong in selecting the construction chosen, that this Court, on appeal, is not bound to follow its conclusions, but may itself determine the meaning of the law.[31] Appellant further contends that if this Court is bound by the construc-

[31] *Waialua Agricultural Co. v. Christian*, 305 U.S. 91, 109, 110, 83 L. ed. 60, 71, 72 (1938).

tion placed upon the law by the Territorial Supreme Court, then the different tax treatment on account of sales to post exchanges as compared to sales to other retailers for resale constitutes a discrimination which would invalidate the Act. Further, appellant contends that factually the discrimination is so clear as to leave no room for question, and that considering the practical effects of the taxing statute, there is such an unreasonable burden placed upon sales to post exchanges as to make the tax unconstitutional.

1. **The General Excise Tax Law properly construed does not impose a tax at a higher rate with respect to sales to post exchanges than with respect to sales to other retailers.**

The reclassification of appellant with regard to his sales to post exchanges and the imposition of the tax with regard to those sales as retail sales at the rate of 1½% rather than as wholesale sales at the rate of ¼ of 1% is justified by the Territory under the provisions of Sec. 1 (10), (12) and (13) of the General Excise Tax Law, which reads in part as follows:

> "Section 1. *Definitions.* When used in this Act, unless otherwise required by the context:
>
> * * * * * * *
>
> (10) 'Wholesaler' or 'jobber' shall apply only to a person doing a regularly organized wholesale or jobbing business, known to the trade as such, and only with respect to the following sales: (a) sales, to a licensed retail merchant or jobber, for purposes of resale; * * *
>
> 'Wholesaler' or 'jobber' shall mean a person, or a definitely organized division thereof, definitely organized to render and rendering a gen-

eral distribution service which buys and maintains at his or its place of business a stock or lines of merchandise which he or it distributes; and which, through salesmen, advertising or sales promotion devices, sells to licensed retailers, or to institutional, or licensed commercial or industrial users, in wholesale quantities and at wholesale rates.

* * * * * * *

(12) 'Retail' means the sale of tangible personal property, other than by a wholesaler as such within the definition of this Act, for consumption or use by the purchaser and not for resale.

(13) 'Retailer' shall mean any person who sells, other than as a wholesaler within the definition of this Act, tangible personal property for consumption or use by the purchaser and not for resale."

Appellant, in selling tangible personal property to post exchanges, was doing a regularly organized wholesale business, known to the trade as such, and all sales were for the purpose of resale. Such sales were not for consumption or use by the purchaser as such words are restricted by the phrase "and not for resale" in the statutory definition of "retail" and "retailer." However, the purchasing post exchanges, operating exclusively under army regulations of the War Department, were not licensed under the Act. They conducted no business that was subject to tax under the Act. They were not wholesalers, jobbers or consumers, but, as instrumentalities of the United States and arms of the War Department, they, in

the performance of constitutional functions, maintained retail stores, bought for the purpose of resale, and resold at the lowest possible price to the armed forces and civilian employees of the Federal Government on army posts for the consumption or use of such purchasers for their convenience and for additional benefits to the armed forces not otherwise provided by the Government. See *Army Regulations;*[32] *Standard Oil Co. of California v. Johnson;*[33] *Federal Land Bank v. Bismarck Lumber Co.*[34]

In holding that with respect to sales to post exchanges appellant was not a wholesaler within the meaning of the Act, the court determined:

(1) That post exchanges were not merchants since their functions are governmental and not proprietary; and

(2) That sales to post exchanges are not to be regarded as sales subject to the wholesale rate since post exchanges are not licensed as that term is used in Sec. 1 (10) (a) of the General Excise Tax Law.

The word "merchant" is not defined in the Act, and its plain, ordinary and commonly accepted meaning must be taken to be the one intended. "Merchant" is defined in Webster's International Dictionary, Second Edition, as: "One who carries on a retail business; a storekeeper or shopkeeper." A "retail merchant" is a paraphrase of the word "retailer" as defined by the Act, and serves to identify the purchaser

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[32]No. 210-65 of the War Department.
[33]316 U.S. 481, 86 L. ed. 1611 (1942).
[34]314 U.S. 95, 86 L. ed. 65 (1941).

as a retailer in contradistinction to a wholesaler, jobber or consumer.[35]

In limiting sales by wholesalers to retailers as the sales to which the wholesale rate is applicable, the Act serves to prevent the lower rate from being applicable in the case of sales by a wholesaler to the consumer. From the facts, it is apparent that post exchanges are retailers, since they carry on retail businesses as retail storekeepers, purchase exclusively as retailers, resell as retailers, and engage in retail activities with the object of economic benefit, either direct or indirect.[36] The court below, in its majority opinion, in holding that post exchanges are not merchants, grounded its determination on the fact that as arms of the Government, the functions of the post exchanges are governmental and not proprietary.

As pointed out in *New York v. United States,*[37] however, any distinction between "governmental" and "proprietary" is applicable in so far as a state tax imposed on a federal agency is concerned; that the considerations bearing on taxes by the states of the activities of the Federal Government are not correlative with the considerations bearing on federal taxation of state agencies or activities; and that the distinction between "governmental" and "proprietary" interests, stressed in the older cases, is untenable. A territory or state cannot tax post exchanges as retail merchants, not because they perform only govern-

[35]See dissenting opinion below (R. 218-219).
[36]See dissenting opinion below (R. 219).
[37]326 U.S. 572, 90 L. ed. 326 (1946).

mental functions as an incident of their relationship to the Federal Government, but because they are part of a department of the Government, and to tax those parts would interfere with the constitutional exercise of federal powers in which the states and their citizens, as well as the Territory and its citizens, are equally interested.[38]

In determining whether the appellant, in dealing with post exchanges, acted as a wholesaler under the General Excise Tax Law, it is apparent that all the requirements relative to the nature of a wholesaler's business and the purposes of sale have been fulfilled except for the requirement that the sale must be to a licensed retail merchant or jobber. Post exchanges are admittedly not jobbers. As pointed out above, appellant contends that they are merchants. The court below held that in order to be a "licensed retail merchant" it was necessary that a license, required of all persons subject to gross income tax under the General Excise Tax Law, be taken out; that post exchanges, being constitutionally immune from being required to take out such a license, were, therefore, not licensed as required in the Act; and that, therefore, the seller to post exchanges could not qualify as a wholesaler with respect to such sales. Appellant contends that this is an erroneous construction of the meaning of the word "licensed" as used in the Act, and is a construction which renders the statute unconstitutional.

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[38]See dissenting opinion below (R. 222-223).

As pointed out in the dissenting opinion,[39] the court might properly have construed the term "licensed retail merchants" to include post exchanges and thus preserve the constitutionality of the Act. The term "licensed" is not defined in the statute. There is no need to confine its definition to the narrow construction placed thereon by the Territorial Supreme Court based on the strict statutory sense of securing a license under the Act. The term "licensed" could properly be held to apply to a retail merchant who is lawfully permitted by proper authority to carry on a retail business which, without such permission, would be illegal. The plain, ordinary and accepted meaning of the term "license" is "authority or liberty given to do or forbear any act; permission to do something (specified); esp., a formal permission from the proper authorities to perform certain acts or to carry on a certain business which without such permission would be illegal; also, the document embodying such permission. * * *"[40] The post exchanges come completely within this definition; they have the permission in the form of army regulations of the War Department pursuant to congressional enactments,[41] to carry on retail businesses within the Territory from the United States as the proper authority under the Constitution, the authorized War Department regulations being the document embodying such permission and having the force of law. Any contention of difference between them and other retail

[39](R. 234 to 237 inclusive).
[40]Webster's International Dictionary, Second Edition.
[41]16 Stat. 315-319; 18 Stat. 337.

merchants would be purely fanciful, and it cannot reasonably be argued that the Legislature ever intended to classify wholesale sales made to retail merchants duly licensed with the Territory by the War Department in accordance with said law under the Constitution differently from those made to retail merchants duly licensed by the Tax Commissioner in accordance with Territorial law under the Act, both purchasers being retailers who are equally law abiding.

Construing the adjective "licensed" in conformity with its plain, ordinary and accepted meaning, the Act is uniform with respect to wholesale sales and operates without discrimination in making applicable the lower rate to the case of a wholesaler. It does so equitably with respect to wholesale sales made to all licensed retail merchants within the Territory, regardless of the source of the purchaser's permission to carry on retail business therein, so long as it is derived from a proper authority and without such permission the conduct thereof would be illegal. Thus construed the Act does not infringe upon or disregard the implied constitutional immunity of purchasing post exchanges engaged in the retail business in the exercise of their right to buy at wholesale within the Territory for purposes of resale. Accordingly, such a tax would be nondiscriminatory.

2. Assuming that the General Excise Tax Law requires the imposition of a higher rate with respect to sales to post exchanges than with respect to sales to other merchants, then said Act is unconstitutional.

The requirement of the statute, as construed by the court below, that a retailer be licensed (that is, required to take out a license under the Act) in order that sales to such retailer be taxed at ¼ of 1% rather than at 1½%, is not a reasonable one. It depends solely on the character of the retailer. The only material respect in which post exchanges differ from other retailers, in the carrying on of their activities, is that post exchanges are not subject to tax by the Territory of Hawaii with respect to sales made by them, since they are agencies or instrumentalities of the United States. That difference, arising from constitutional immunity, cannot be made the basis of a discrimination against them in respect to the purchases they make. The difference in character of sales, on which the rate is based, must have a reasonable relationship to the purpose of the legislation. The fact that in effect the post exchange is an arm of the Government does not justify any difference in taxes on account of purchases made by it. See *Quaker City Cab Co. v. Pennsylvania,*[42] *Southern R. Co. v. Greene,*[43] *Bethelehem Motors Corp. v. Flynt,*[44] *Concordia Fire Ins. Co. v. Illinois.*[45].

The only reason why the purchasing post exchanges have an unlicensed status under the Act is because

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[42]277 U.S. 389, 72 L. ed. 927 (1928).
[43]216 U.S. 400, 54 L. ed. 536 (1910).
[44]256 U.S. 421, 65 L. ed. 1029 (1921).
[45]292 U.S. 535, 78 L. ed. 1411 (1934).

they are exempt on their resales from taxation by the Constitution of the United States. It is apparent, therefore, that the constitutional exemption is not disregarded, but, on the contrary, is the basic reason for the higher assessment. In so far as the Supreme Court of the Territory of Hawaii holds that the Act must be construed as imposing a higher tax on sales to post exchanges than on sales to other retailers, the Act must be regarded as attempting to obtain on immediate sale that which would be constitutionally unobtainable on subsequent resale. Such would be the effect notwithstanding the fact that the unlicensed status under the Act of the post exchanges, by reason of constitutional exemption, and what would be the different status of other purchasing retail merchants required to have a license under the Act, have no bearing whatsoever upon their respective purchasing characters in immediate sales to them. Their relative status with respect to being licensed relates wholly to their respective taxable and nontaxable characters under the Act upon subsequent resale, neither status affecting either the right or privilege of purchase. Such would be the effect even though there is no real or substantial difference between their purchasing characters at the time of purchase, their purposes of buying being the same and the nature of their retail purposes substantially the same. This would be so even though there is no reasonable or tenable distinction to be found in the fact that post exchanges exercise their right of purchase under authorized War Department regulations as a constitutional function and other purchasing retail merchants exercise

their privilege of purchase under a license provided by the Act as a proprietary function.[46]

The fact that there appears to be equal treatment under the Act to sales for resale to those exempted by the Act itself, does not serve to remove the discrimination. The Legislature may exempt any otherwise taxable person, and has the power to withdraw the exemption granted at any time within its discretion as dictated by the equitable and economic necessities of the case. The Legislature has with one hand, in effect, extended exemption to certain otherwise taxable persons as well as to public utilities of the Territory and its subdivisions, and, with the other hand, partly withheld the full force of such exemptions. However, it cannot withdraw, nor effectively consent to that which it did not give, nor can it take away any part of an immunity impliedly granted under the Constitution. The considerations with respect to persons exempted by the Act have no relation to those exempted under the Constitution, and the fact that the Act would appear to operate equally with respect to sales to them is immaterial. It is only with respect to the unequal operation of the law as construed toward substantially the same purchasers who were not exempted by the Act that this court should be concerned. The question, therefore, is whether the assessment of the higher rate with respect to sales to post exchanges, which were constitutionally exempt, on resale, when the lower rate is assessed with respect to such other retail merchants

[46]See dissenting opinion below (R. 221).

not so exempt, constitutes a discriminatory tax that directly trespasses upon the immunity impliedly afforded by the Constitution to post exchanges and renders the legislative authority to assess the higher rate unconstitutional and invalid.[47]

In considering this question, the practical operation and effect of the Act under the construction given it by the Supreme Court as at the time of purchase must be determined. It is obvious that the Act would operate to tax gross proceeds of sales to post exchanges at a rate six times as great as that assessed against those to other retail merchants, and, by so doing, would impose upon post exchanges in the exercise of their right of purchase, a relatively greater burden than that upon the others in the exercise of their privilege of purchase. In addition, it would place an excessive burden upon the right of purchase of post exchanges that would not be imposed had they not been clothed with an implied constitutional immunity. It is obvious that the effect thereof directly would tend to discourage sales to post exchanges while encouraging those to other retail merchants. Such treatment would unquestionably be unfair and injurious to post exchanges. It justifies the inference that the Act so construed would be unfair in design, favoring retail businesses within the Territory which are in competition to government retail businesses. Such an ununiform excise tax law is discriminatory in so far as the exercise of the right of purchase by post exchanges is concerned.[48]

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[47]See dissenting opinion below (R. 223 to 225 inclusive).
[48]See dissenting opinion below (R. 225).

As stated by the Supreme Court in *New York v. United States, supra,* "* * * 'discrimination' is not a code of specific but a continuous process of application * * *" and, as pointed out by Mr. Justice Holmes in his dissenting opinion in the *Panhandle* case, *supra,* "* * * this court which so often has defeated the attempt to tax in certain ways can defeat an attempt to discriminate or otherwise go too far without wholly abolishing the power to tax. The power to tax is not the power to destroy while this court sits. The power to fix rates is the power to destroy if unlimited, but this court while it endeavors to prevent confiscation does not prevent the fixing of rates. * * *"

Thus, discrimination being a continuous process of application, it follows that if the Territory has the power to fix a discriminatory rate with respect to sales to post exchanges substantially higher than with those to other retail merchants, it could fix one still higher and so could the states, thereby effectively expelling post exchanges from territorial and state limits, drying up at its source the necessary flow of merchandise and rendering post exchanges unable to function in defeat of the purpose for which they were created. It is evident therefrom that the power to fix a discriminatory rate is unlimited and hence the power which destroys.[49] This court should therefore defeat such an attempt to discriminate and prevent the confiscatory assessments from being applied, the pertinent issue under the considered construction

[49]See dissenting opinion below (R. 228).

being whether the assessment made by the tax commissioner would trespass upon the implied constitutional immunity of post exchanges as an immediate or direct interference with the Government's constitutional powers to operate them under the Constitution.[50]

The court below says, with regard to this question, that the question depends on the absorption of the tax by the retailer, and that post exchanges, by reason of their immunity, absorb less in taxes under the General Excise Tax Law than licensed retail merchants in that, in the case of post exchanges, the tax to be absorbed is 1½% and, in the case of licensed retail merchants, 1¾%, and that the result is that the purchasers, to whom sales at post exchanges are restricted, as ultimate consumers pay less than the general public purchasing from licensed retail merchants. This reasoning lumps together the taxes imposed on account of two sales; namely, the sale from the wholesaler to the retailer, and the sale by the wholesaler to the consumer. The tax levied on the sale from the wholesaler to the licensed retailer is ¼ of 1%, and the tax on the resale by the retailer is 1½%, making a total of 1¾%.

The very cases relied on by the court below to hold that nondiscriminatory taxes on account of sales to the United States are valid, rest on the reasoning that the ultimate burden of the tax is unimportant. The court below blows hot and cold when it holds that the fact of the burden falling on the Government is

[50]Const., Art. I, Sec. 8.

unimportant in order to sustain the validity of the tax in the first instance, and then argues on the basis of the ultimate absorption of the tax in order to prove that there is no discrimination against the post exchanges. If nothing else, this holding makes clear the purpose of the Territory to collect from the seller to post exchanges a tax at a rate which makes up for the tax on the ultimate retail sale by the post exchange which cannot be levied directly because of the constitutional prohibition.

A rather similar case is that of *Missouri ex rel. Missouri Ins. Co. v. Gehner,*[51] where a state tax was imposed upon all insurance companies measured in part by the net value of all of its assets in excess of the legally required reserve necessary to reinsure its outstanding risks and unpaid policy claims. The question before the court was whether the company could deduct from its return the value of United States bonds owned by it. The court said at page 876:

> "* * * It necessarily follows from the immunity created by a Federal authority that a state may not subject one to a greater burden upon his taxable property merely because he owns tax-exempt government securities. Neither ingenuity in calculation nor form of words in state enactments can deprive the owner of the tax exemption established for the benefit of the United States. * * *
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> "* * * It is clear that the value of appellant's government bonds was not disregarded in making

[51] 281 U.S. 313, 74 L. ed. 870 (1930).

> up the estimate of taxable net values. That is in violation of the established rule. * * *"

That is exactly what has happened in the present case. The tax exemption on sales that would otherwise have afforded an advantage to post exchanges is diminished by imposing a greater tax on account of their purchases. In other words, the Territory, which cannot tax the sales of post exchanges, is attempting to tax their purchases at a higher rate than the tax imposed on similar transactions not involving post exchanges. It is clear that the immunity to tax of sales by the post exchanges was not disregarded in determining the rate of tax payable on account of purchases by them. This is in violation of the established rule that what is immune from tax may not be indirectly taxed in other ways and that the attempt to increase the tax in the manner that the Territory purports to do constitutes undue discrimination against a tax exempt agency or instrumentality.

In any event, it is quite apparent that regardless of any other consideration, it does happen that of all retailers who purchased for resale (with the exception of a few taxpayers exempt from tax on their sales by Territorial law), it is only on the purchases of post exchanges that a higher rate of tax results. That this constitutes a direct interference with federal functions is quite apparent, particularly during war times when the freedom of purchase was substantially restricted by war-time shortages. In the case of post exchanges, because of the imposition of a tax on account of their purchases at a rate six times

as high as that imposed upon purchases of any other purchaser for resale, the court can well understand the difficulties post exchanges would encounter in purchasing what they required to perform their functions. As the United States Supreme Court said in *McLeod v. Dillworth, supra,* in characterizing a sales tax on the freedom of purchase, such freedom of purchase is a freedom which war-time restrictions served to emphasize.

CONCLUSION.

It is, therefore, respectfully submitted that:

I. The Territory of Hawaii cannot lawfully impose a tax on the gross receipts from sales to the United States or its agencies or instrumentalities.

(a) The Territory of Hawaii is not a sovereign government with inherent power to impose taxes, but derives its power to tax from the United States.

(b) Congress has never delegated to the Territory of Hawaii the power to tax the United States or its agencies or instrumentalities.

(c) A statute which includes the gross receipts from sales to the United States or its agencies or instrumentalities, within the measure of the tax, is a tax on the United States.

(d) The *Panhandle* line of cases has not been overruled in so far as it holds that a tax on account of sales to the United States is unconstitutional.

II. The Territory of Hawaii cannot lawfully impose a tax at a higher rate with respect to sales to post exchanges than with respect to sales to other retail merchants for resale.

(a) The General Excise Tax Law properly construed does not impose a tax at a higher rate with respect to sales to post exchanges than with respect to sales to other retailers.

(b) Assuming that the General Excise Tax Law requires the imposition of a higher rate with respect to sales to post exchanges than with respect to sales to other merchants, then said Act is unconstitutional.

Dated, Honolulu, T. H.
November 15, 1947.

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